

Message Text

LIMITED OFFICIAL USE

PAGE 01 OTTAWA 01989 01 OF 03 190038Z
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 PA-01 AGRE-00 /092 W
-----069271 190109Z /63

R 190009Z APR 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC 7091
INFO AMEMBASSY BRUSSELS
AMEMBASSY PARIS
AMCONSUL MONTREAL
ALL OTHER CONGENS IN CANADA POUCH

LIMITED OFFICIAL USE SECTION 01 OF 03 OTTAWA 01989

BRUSSELS FOR USEEC

PARIS FOR USOECD

DEPT. PASS CEA, TREAS, FRB

E.O. 11652:N/A
TAGS: EFIN, ECON, CA
SUBJECT: MACRO-ECONOMIC IMPACT OF GOC BUDGET

REFS: A. OTTAWA 1814; B. OTTAWA 1746; C. MONTREAL 696;
D. OTTAWA 1911; E. OTTAWA 1945; F. WINNIPEG 173.

1. SUMMARY. GOC'S APRIL 10 BUDGET WILL HAVE ONLY A MINIMAL
IMPACT ON REAL GNP GROWTH IN 1978. IMPETUS TO GROWTH
DERIVES FROM SALES TAX CUT WHICH SHOULD BOOST REAL INCOMES
BY REDUCING INFLATION RATE. IN ADDITION, ACCELERATION OF
SPENDING EXPECTED IN ANTICIPATION OF RETURN TO HIGHER SALES
TAXES IN SEPTEMBER IN MOST PROVINCES. FY 1978/79 FEDERAL
LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 OTTAWA 01989 01 OF 03 190038Z

BUDGET DEFICIT BASED ON OPTIMISTIC REAL GROWTH PROJECTIONS
AND COULD WELL BE HIGHER THAN CDOLS 11.5 BILLION OFFICIALLY
FORECAST. MOST INTEREST GROUPS FELT BUDGET WENT IN RIGHT
DIRECTION, BUT NOT FAR ENOUGH. SOME PROVINCES, NOTABLY
QUEBEC, SAW PROPOSED SALES TAX PACKAGE AS INFRINGEMENT ON
PROVINCIAL JURISDICTION. ASSESSMENT OF FINANCIAL COMMUNITY
IS THAT BUDGET WAS ABOUT BEST THAT GOC COULD DO GIVEN ITS

LIMITED ROOM FOR MANOEUVRE. END SUMMARY.

2. PRICE IMPACT. IN BUDGET DOCUMENT, GOC ESTIMATES THAT CUTTING SALES TAXES (3 PERCENTAGE POINT CUT OVER SIX MONTHS OR 2 PERCENTAGE POINT CUT OVER 9 MONTHS) WOULD PRODUCE 1 PERCENTAGE POINT REDUCTION IN CONSUMER PRICE INCREASE FOR PERIOD TAX CUTS ARE IN EFFECT. THIS IMPLIES THAT CPI INCREASE IN 1978 WILL BE ABOUT ONE-HALF PERCENTAGE POINT LESS THAN IT OTHERWISE WOULD HAVE BEEN. IN REF. B EMBASSY FORECAST 7.5 PERCENT RISE IN CPI IN 1978, BUT NOTED THAT UPSIDE RISK TO THAT FORECAST HAD INCREASED DUE TO FURTHER DEPRECIATION OF CANADIAN DOLLAR IN FIRST QUARTER OF THIS YEAR. CUT IN SALES TAX LARGELY ELIMINATES THIS RISK AND COULD BRING DOWN 1978 INFLATION RATE TO SLIGHTLY LESS THAN 7.5 PERCENT WITH CONCOMITANT BOOST TO REAL INCOMES.

3. BANK OF CANADA (BOC) OFFICIAL TOLD EMBOFF THAT BOC INTERNAL ESTIMATES PUT PRICE IMPACT OF TAX CUTS AT SOMEWHAT LESS THAN ONE PERCENTAGE POINT (0.8 - 0.9 PERCENTAGE POINT) DURING PERIOD CUTS ARE IN EFFECT. THE OFFICIAL ALSO NOTED THAT EFFECT OF CUTS DIFFICULT TO MEASURE SINCE SOME INTERMEDIATE GOODS AS WELL AS FINAL PRODUCTS ARE SUBJECT TO SALES TAX. IN ANY CASE, FULL PASS-THROUGH TO CONSUMERS OF SALES TAX CUTS MUST TAKE PLACE TO OBTAIN MAXIMUM BENEFICIAL EFFECT ON PRICES. SLACK DEMAND CONDITIONS AND LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 OTTAWA 01989 01 OF 03 190038Z

CONSIDERABLE PUBLIC ATTENTION GIVEN TO PROVINCIAL MOVES TO CUT TAXES WILL HELP INSURE THAT FULL PASS-THROUGH TAKES PLACE. QUEBEC'S DECISION TO ELIMINATE SALES TAX FOR ONE YEAR ON SELECTED PRODUCTS (SEE REF C) MAY NOT ALTER ESTIMATED PRICE IMPACT OF TAX CUTS. MEASURE, UNLIKE GOC PROPOSAL, APPLIES ONLY TO SELECTED COMMODITIES, BUT QUEBEC CUTS ARE DEEPER.

4. GROWTH IMPACT. GROWTH IMPACT OF BUDGET DEPENDS ON NET INFLUENCE OF: (A) SOMEWHAT FASTER GROWTH OF REAL INCOMES AND HENCE OF CONSUMPTION DUE TO MODERATING INFLUENCE ON PRICES OF SALES TAX CUTS; (B) ANTICIPATORY SPENDING IN ADVANCE OF RETURN TO ORIGINAL TAX LEVELS AND (C) DEPRESSANT INFLUENCE OF CDOLS 350 MILLION CUT IN FEDERAL GOVERNMENT SPENDING. CUT IN SALES TAXES BY ITSELF SHOULD INCREASE GROWTH OF REAL INCOME AND CONSUMPTION BY SOMETHING LESS THAN ONE-HALF OF ONE PERCENT. HOWEVER, THIS BOOST TO GNP GROWTH WOULD BE OFFSET BY CDOLS 350 MILLION CUT IN PLANNED FEDERAL SPENDING PROPOSED IN BUDGET. THUS, ANY NET INCREASE IN GROWTH FROM BUDGET PROPOSALS WILL COME FROM ACCELERATION OF SPENDING (PARTICULARLY ON CONSUMER DURABLES) IN ADVANCE OF RISE IN TAXES TO PRE-BUDGET LEVELS.

5. THE MAGNITUDE OF SUCH ANTICIPATORY SPENDING IS HIGHLY UNCERTAIN, HENCE ESTIMATE OF EFFECT ON GROWTH OF TAX CUTS IS SUBJECT TO WIDE MARGIN OF ERROR. GOC HAD ESTIMATED THAT BUDGET PROPOSALS WOULD INCREASE GNP GROWTH IN CY 1978 BY 0.5 PERCENTAGE POINT OR LESS, POSSIBLY BY AS LITTLE AS 0.25 PERCENTAGE POINT. THIS PROJECTION SHOULD BE REVISED DOWNWARD IN LIGHT OF QUEBEC'S DECISION TO ELIMINATE SALES TAXES FOR ONE YEAR (ENDING APRIL 13, 1979) SINCE ACCELERATION OF SPENDING WOULD NOT TAKE PLACE UNTIL FIRST QUARTER OF 1979. ON BALANCE, WE ESTIMATE GNP WILL BE ONLY MARGI-

LIMITED OFFICIAL USE

NNN

LIMITED OFFICIAL USE

PAGE 01 OTTAWA 01989 02 OF 03 190719Z
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03

SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07

CEA-01 PA-01 AGRE-00 /092 W

-----074125 190729Z /20/63

R 190009Z APR 78

FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC 7092

INFO AMMBASSY BRUSSELS 1136

AMEMBASSY PARIS

AMCONSUL MONTREAL

ALL OTHER CONGENS IN CANADA POUCH

LIMITED OFFICIAL USE SECTION 02 OF 03 OTTAWA 01989

C O R R C T E D C O P Y DUE TO OMISSIONS IN TEXT

6. PRIOR TO INTRODUCTION OF BUDGET, GOC ESTIMATED THAT "HIGH EMPLOYMENT" BUDGET BALANCE OF ALL LEVELS OF GOVERNMENT WOULD MOVE FROM SURPLUS OF CDOLS 2.0 BILLION IN CY 1977 TO SURPLUS OF CDOLS 0.5 BILLION IN CY 1978. GOC HAD EXPECTED FEDERAL GOVERNMENT HIGH EMPLOYMENT DEFICIT TO INCREASE BY ABOUT CDOLS 2.5 BILLION TO CDOLS 4.5 BILLION AND SURPLUS OF ALL OTHER LEVELS OF GOVERNMENT TO RISE BY CDOLS 0.5 BILLION TO CDOLS 2.3 BILLION. PROJECTIONS IMPLIED VIRTUAL BALANCE IN HIGH EMPLOYMENT BUDGET IN CY 1978, A SMALL SWING TOWARD LOWER SURPLUS OF CDOLS 1.5 BILLION, OR JUST OVER 0.5 PERCENT OF 1978 GNP. GOC OFFICIALS TOLD EMBOFF THEY DOUBTED THAT BUDGET PROPOSALS WOULD

GREATLY ALTER PROJECTED CHANGE IN HIGH EMPLOYMENT SURPLUS IN 1978. THIS IS FURTHER EVIDENCE THAT IMPACT OF BUDGET ON GNP GROWTH LIKELY TO BE SMALL.

7. FISCAL IMPACT. BUDGET PROPOSES THAT FEDERAL SPENDING LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 OTTAWA 01989 02 OF 03 190719Z

IN FY 1978/79 BE CUT BY CDOLS 350 MILLION FROM LEVEL SHOWN IN FEBRUARY SPENDING ESTIMATES. (SEE REF B; ACTUAL SPENDING LEVELS CONTAINED IN BUDGET AND IN FEBRUARY ESTIMATES NOT DIRECTLY COMPARABLE SINCE BUDGET PRESENTED ON NATIONAL ACCOUNTS BASIS AND FEBRUARY PROJECTION SHOWN ON PUBLIC ACCOUNTS BASIS.) ON NATIONAL ACCOUNTS BASIS, GOC PROJECTS EXPENDITURES OF CDOLS 49.8 BILLION AND REVENUES OF CDOLS 40.5 BILLION YIELDING CDOLS 9.3 BILLION CURRENT DEFICIT. DEFICIT ON NON-BUDGETARY TRANSACTIONS FORECAST AT CDOLS 2.3 BILLION, PRODUCING TOTAL FINANCING REQUIREMENT OF ABOUT CDOLS 11.6 BILLION (EXCLUDING FOREIGN EXCHANGE TRANSACTIONS).

8. GOC FORECAST OF CDOLS 11.5 BILLION FINANCING REQUIREMENT IN FY 1978/79 ASSUMED 5 PERCENT GROWTH OF REAL GNP AND 6 PERCENT INCREASE IN GNP DEFLATOR, GIVING 11 PERCENT INCREASE IN NOMINAL GNP. SHOULD NOMINAL GNP GROW MORE SLOWLY THAN 11 PERCENT, REVENUES WOULD BE LOWER THAN EXPECTED, EXPENDITURES POSSIBLY HIGHER AND FINANCING REQUIREMENT CONCOMITANTLY LARGER. DEPT. OF FINANCE ESTIMATES THAT FINANCING REQUIREMENT WOULD INCREASE BY CDOLS 500 - 750 MILLION FOR EACH PERCENTAGE POINT ACTUAL NOMINAL GNP GROWTH RATE FALLS SHORT OF PROJECTED RATE. GOC'S ASSUMPTION OF 5 PERCENT REAL GROWTH IS HIGHLY OPTIMISTIC. HOWEVER, INFLATION (GNP DEFLATOR) COULD WELL BE HIGHER THAN 6 PERCENT ASSUMED. CONSEQUENTLY, GROWTH OF NOMINAL GNP IN FY 1978/79 AND MAGNITUDE OF BUDGET DEFICIT MAY NOT DIVERGE SIGNIFICANTLY FROM BUDGET FORECAST ALTHOUGH MIX BETWEEN REAL GROWTH AND INFLATION LIKELY TO BE LESS FAVORABLE THAN FORECAST.

9. UNDER ASSUMPTION THAT EMBASSY'S FORECASTS FOR CY 1978 (3.6 PERCENT REAL GROWTH; 6.5 PERCENT INCREASE IN GNP LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 OTTAWA 01989 02 OF 03 190719Z

DEFLATOR) ARE VALID FOR FY 1978/79, WE ESTIMATE FINANCING REQUIREMENT OF ABOUT CDOLS 12 BILLION, COMPARED WITH GOC FORECAST OF CDOLS 11.5 BILLION. (GOC DECISION TO FUND SMALLER THAN INTENDED PORTION OF SALES TAX CUTS IN QUEBEC

LIMITED OFFICIAL USE

NNN

LIMITED OFFICIAL USE

PAGE 01 OTTAWA 01989 03 OF 03 190050Z
ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 PA-01 AGRE-00 /092 W
-----069345 190111Z /63

R 190009Z APR 78
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC 7093
INFO AMEMBASSY BRUSSELS
AMEMBASSY PARIS
AMCONSUL MONTREAL
ALL OTHER CONGENS IN CANADA POUCH

LIMITED OFFICIAL USE SECTION 03 OF 03 OTTAWA 01989

WILL REDUCE FEDERAL GOVERNMENT DEFICIT BY ABOUT CDOLS
189 MILLION. -- SEE OTTAWA 1945.)

10. EXCHANGE RATE IMPACT. EFFECT OF BUDGET ON EXCHANGE
MARKETS DIFFICULT TO GAUGE. SMALL INCREASE IN BUDGET
DEFICIT AND FAVORABLE IMPACT ON INFLATION OF PROPOSED
REDUCTION IN SALES TAXES MIGHT HAVE HAD FAVORABLE IMPACT
ON CANADIAN DOLLAR EXCHANGE RATE. HOWEVER, ANNOUNCEMENT
SHORTLY AFTER INTRODUCTION OF BUDGET OF HIGHER INFLATION
AND UNEMPLOYMENT RATE IN MARCH AND GOC/QUEBEC WRANGLING
PRESSURE IN EXCESS OF ANY (PROBABLY SMALL) BOOST THAT
MIGHT HAVE BEEN PROVIDED BY BUDGET.

11. COMMENT. GOC'S EFFORT TO COMBINE FISCAL RESTRAINT WITH
POLITICAL BALANCE IN BUDGET RESULTED IN SPRINKLING OF
BENEFITS ACROSS BROAD SPECTRUM OF INTEREST GROUPS. THUS,
REACTION OF MOST GROUPS WAS THAT BUDGET WENT IN RIGHT
DIRECTION, BUT NOT FAR ENOUGH. ASSESSMENT OF FINANCIAL
COMMUNITY WAS THAT BUDGET WAS BEST GOC COULD GO, GIVEN
LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 OTTAWA 01989 03 OF 03 190050Z

LIMITED FREEDOM TO MANOEUVRE.

12. QUEBEC DECRIED GOC'S EFFORT TO COMBINE FISCAL RESTRAINT WITH FUNDING OF PROVINCIAL SALES TAX CUTS AS UNWARRANTED INFRINGEMENT OF PROVINCIAL JURISDICTION (A "SHAMELESS RAPE" OF PROVINCIAL TAX POWERS, IN THE WORDS OF LEVESQUE). WESTERN PREMIERS HAVE ISSUED SIMILAR COMPLAINTS (SEE SEP-TEL). POLITICAL OPPOSITION HAS SEIZED UPON SALES TAX ISSUE, CHARGING THAT GOC ACTIONS MADE MOCKERY OF FEDERAL/ PROVINCIAL COLLABORATION ON ECONOMIC POLICY.

13. IN EMBASSY VIEW, GOC WAS CONSTRAINED BY ECONOMIC CIRCUMSTANCES FROM PROVIDING STRONGER STIMULUS TO GROWTH. A SIGNIFICANT INCREASE IN BUDGET DEFICIT MIGHT NOT HAVE HAD DIRECT INFLATIONARY EFFECT (GIVEN SUBSTANTIAL EXCESS CAPACITY), BUT COULD WELL HAVE BEEN VIEWED AS AN IRRESPONSIBLE ELECTION MOVE BY THE ALREADY JITTERY FINANCIAL COMMUNITY - SENDING DOLLAR FURTHER DOWNWARD, THEREBY GENERATING ADDITIONAL INFLATIONARY PRESSURE. IN SITUATION OF WEAK EXPECTED GROWTH, HIGH INFLATION RATE AND OTHER LIMITS ON SIZE OF MEASURES WHICH COULD BE UNDERTAKEN, CUT IN SALES TAXES (AS OPPOSED TO INCOME TAXES) WAS PROBABLY A GOOD CHOICE. TEMPORARY SALES TAX CUT:(A) HELPS REDUCE INFLATION; (B) RAISES DISPOSABLE INCOMES IN WAY WHICH MINIMIZES POSSIBILITY THAT HIGHER INCOMES WILL GO INTO SAVINGS; (C) CAN GENERATE CONSUMPTION SPURT - AT NO COST TO GOVERNMENTS - IN ANTICIPATION OF RETURN OF SALES TAXES TO PRE-BUDGET LEVELS. RISK OF ADVERSE PROVINCIAL REACTION TO PROPOSED CONDITIONAL FUNDING OF PROVINCIAL TAX CUTS WOULD HAVE REDUCED ATTRACTIVENESS OF THIS OPTION, BUT GOC : EVIDENTLY FELT IT HAD COVERED THIS BASE IN PRE-BUDGET CONSULTATIONS WITH PROVINCES.

LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 OTTAWA 01989 03 OF 03 190050Z

14. STRUCTURAL MEASURES IN BUDGET, SUCH AS STIMULUS TO R&D AND ENERGY INVESTMENT, SHOULD PRODUCE BENEFITS OVER MEDIUM TERM. HOWEVER, THEIR SHORT RUN EFFECT WILL BE NEGLIGIBLE AND THEY WERE INCLUDED TO GIVE BUDGET NEEDED POLITICAL BALANCE AND BECAUSE THEY WOULD PROBABLY NOT COST MUCH OVER NEXT 12 MONTHS. ENDERS

LIMITED OFFICIAL USE

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: GOVERNMENT BUDGET, ECONOMIC TRENDS, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 19 apr 1978
Decaption Date: 20 Mar 2014
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978OTTAWA01989
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780166-0846
Format: TEL
From: OTTAWA
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780440/aaaabhnr.tel
Line Count: 324
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 3d838bab-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: ONLY
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: ONLY
Reference: 78 OTTAWA 1814, 78 OTTAWA 1746, 78 MONTREAL 696, 78 OTTAWA 1911, 78 OTTAWA 1945, 78 WINNIPEG 173
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2919363
Secure: OPEN
Status: NATIVE
Subject: MACRO-ECONOMIC IMPACT OF GOC BUDGET
TAGS: EFIN, ECON, CA
To: STATE
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/3d838bab-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014